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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63
	)	
Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	CC Docket No. 98-157

COMMENTS OF GTE

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SUMMARY

GTE urges the Commission to continue down the path it embarked upon when it initiated the access reform proceedings: to eliminate pricing inefficiencies from ILEC access rates by deregulating its pricing rules. The journey is far from complete as access prices remain encumbered by far too many uneconomic policies, implicit subsidies, and inflexible rate structure regulations.

The present *FNPRM* takes some additional steps forward, but also some steps back. In the *FNPRM*, the FCC requests comment for further deregulation in two areas: (1) geographic deaveraging of switched access services and (2) Phase II flexibility for switched access services. These are sound proposals and should be adopted promptly. Unfortunately, other portions of the *FNPRM* veer from the deregulatory path by suggesting new and potentially burdensome revisions to the price cap rules and the Part 69 switching rate structure, and new regulation of non-dominant CLECs. These proposals are completely counter to the thrust of the other deregulatory initiatives and ignore the market's effect on access prices.

In particular, the Commission should give ILECs the flexibility to implement, if the ILEC finds that it makes economic sense, non-mandatory deaveraging of common line and switching prices. In addition, ILECs need the flexibility to establish different zones for loop and transport pricing if it makes sense to do so or to maintain the same zones if costs do not justify a separate set of zones. Finally, the benefits of deaveraging will not be achieved if SLC caps remain at their present levels, which simply do not provide enough room for SLC deaveraging. GTE suggests that the Commission adjust current

price caps pursuant to the gradual modifications specified in the CALLS proposal. This plan provides a comprehensive, albeit interim, means to realign access pricing in a way that promotes competition and proper cost recovery while offering a modest explicit universal services support mechanism.

A second important step is to apply the framework for pricing flexibility outlined in the *Fifth Report & Order* for proceeding to Phase II deregulation of common line and switching services. ILECs also should be permitted to make a separate showing that Phase II triggers have been met based on different classes of customers. The Commission already has validated the distinction between business and residential users in other contexts, and this approach would reflect the fact that competitors entering new markets primarily target business customers. Furthermore, GTE suggests that, in the interest of regulatory consistency, ILECs should be permitted to make an alternative showing based on their competitors' ability to offer service to customers who represent a substantial level of ILEC revenue. Because significant competition will protect consumers, there is no need to adopt special safeguards.

In contrast, GTE opposes other aspects of the *FNPRM* that step off the path to deregulation. For one, the Commission requests comment on a major revision of the pricing structure that would move away from the existing per-minute/per-call system to one based on a capacity-based theory. Mandating such dramatic rate structure shifts in today's environment is both unnecessary and wasteful. First, GTE is quite surprised to see, at this late stage, a proposal to change the access charge structure that does nothing to further the Commission's ultimate goal of *eliminating* the rules governing access charges. Second, this approach ignores earlier findings that a rigid access charge structure limits the industry's ability to react to changes in technology, differences in geography and customer needs, and to the development of competition. Third, while the FCC suggests that capacity-based prices would be a "magic wand" to obviate these difficulties, capacity-based pricing actually shares many of the same practical difficulties of peak/off-peak pricing, and it is not clear that efficiency would be improved in the manner the *FNPRM* expects. The Commission should move swiftly to deregulate these prices by removing them from the scope of Part 69, rather than add yet another layer of mandates to the Rules.

GTE suggests that the Commission would take another misstep if it ratified the FNPRM's proposals to modify the "g" factor and introduce a "q" factor. These plans ignore the fact that the current X-Factor automatically adjusts for differences in changes between usage and capacity. Thus, the "g" factor should never have been adopted in the first instance. The adoption of a "q" factor would not mitigate the effects of the system of imperfect cost recovery, but rather would "double count the effects of demand growth" to the detriment of ILECs.

The Commission further detours from the deregulatory path with its proposal to realign baskets for flat-rate, trunk-port charges and traffic-sensitive services. GTE does not support this realignment of the existing basket structure and believes that the proposal to reorganize this system will result in increased costs for price cap LECs while providing no benefit for consumers. Rather, GTE believes that streamlining the basket and band structure along the lines proposed by USTA would lead to more efficient pricing and, consequently, increase consumer benefits.

The *FNPRM* also asks whether different growth rates will create any windfall or shortfall for carriers, and whether the formula in Section 61.46(d)(1) should be revised. GTE believes that this change is unnecessary for a number of reasons. Regardless, adoption of the CALLS proposal would more efficiently accomplish the FNPRM's goals. On the other hand, GTE does not object to the use of the chain-weighted GDP-PI in the PCI formula, because a chain-weighted measure has been employed by the Commission elsewhere, and its use in this instance will serve to bring consistency to the calculation of the PCI. GTE would vehemently oppose, however, any requirement that this change be applied on a retroactive basis.

Finally, the FCC seeks input regarding the prospect of increasing regulation of non-dominant CLECs. GTE believes that the Commission should not do so in the absence of strong evidence that a widespread problem exists and that the tools already available, such as the Section 208 complaint process and further deregulation of ILECs, are inadequate. Given that CLECs have been found to lack the market power to justify dominant carrier regulation, the burden is on the proponents of regulating non-dominant CLECs to provide strong evidence for doing so. Anecdotal reports do not justify a leap to a regulatory response. A superior solution permits ILECs to price their competing services flexibly in response to market signals thereby unleashing the discipline of fully competitive market forces on CLEC prices.

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COMMENTS OF GTE

GTE Service Corporation and its below-listed affiliates (collectively "GTE")[1] respectfully submit their Comments on the Further Notice of Proposed Rulemaking in the above-captioned docket.[2] In particular, the Commission has solicited comment on

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1 GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, Contel of the South, Inc., and GTE Communications Corporation.

2 Access Charge Reform, CC Docket No. 96-262, *et al.*, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, FCC 99-206 (rel. Aug. 27, 1999) (hereinafter "*Fifth Report and Order*" and "*FNPRM*").

proposals to reduce regulation of access services of incumbent local exchange carriers ("ILECs") in the form of geographic deaveraging of switched access services and Phase II pricing flexibility for switched services. GTE generally supports these proposals. However, GTE opposes other proposals in the *FNPRM* to *increase* regulation, including restructuring certain switched services, further changes to the price cap regime, and imposing regulation on the terminating access rates of competitive local exchange carriers ("CLECs").

Rather than focus on further micromanagement of access pricing, the FCC should adopt the proposal submitted by the Coalition for Affordable Local and Long Distance Services ("CALLS") on August 20.[3] GTE strongly encourages the Commission, when considering the issues in the *FNPRM*, to recognize that the CALLS plan offers a responsible solution that eliminates many of the restructuring issues in this proceeding. In particular, by making universal support subsidies explicit, moving Subscriber Line Charges ("SLCs") closer to costs, and substantially reducing average switching rates, the CALLS plan will significantly move access prices towards cost-based, efficient levels.

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3 Ex Parte Letter from John Nakahata to Magalie Roman Salas (FCC, Secretary) on August 20, 1999 (attachment, Memorandum in Support of the Coalition for Affordable Local And Long Distance Service Plan ("CALLS Proposal"); *see also* Access Charge Reform, CC Docket Nos. 96-262, *et al.*, *Notice of Proposed Rulemaking*, FCC 99-235 (rel. Sept. 15, 1999).

I. INTRODUCTION.

For too many years, a complex set of Commission regulations has specified the structure of access charges, including an array of hidden subsidies designed to serve various policy objectives. This structure – which by deliberate regulatory design produces prices that are not market-based, are economically inefficient, and send inaccurate signals to both customers and competitors – is no longer tenable as the access market grows steadily competitive. For this reason, the agency has labored in its "trilogy" of proceedings in the more than 3.5 years since the enactment of the Telecommunications Act of 1996 (the "Act") to reform access charges along with universal service and the price cap structure. The *Fifth Report and Order* and *FNPRM* are the latest steps in the Commission's effort to transform the mechanism for establishing prices for interstate access services provided by ILECs to a "market-based approach to drive interstate access charges toward the costs of providing these services."[4]

While the partial relief from the rigid constraints of Part 69 provided by the *Fifth Report and Order* constitutes a step in the right direction, access prices remain encumbered by far too many uneconomic policies, implicit subsidies, and inflexible rate structure regulations. Making a partial step towards reducing these flaws, the *FNPRM* invites comment on several proposals for further deregulation in two areas: (1)

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4 *Fifth Report and Order*, at ¶ 2 (citing *Access Reform First Report and Order*, 12 FCC Rcd 15985, 16094 (1997)).

geographic deaveraging of switched access services and (2) Phase II flexibility for switched access services. These are sound proposals and should be adopted promptly.

Unaccountably, however, other portions of the *FNPRM* take a dramatically opposite approach from its otherwise deregulatory direction by proposing new and potentially burdensome revisions to the price cap rules, to the Part 69 switching rate structure, and even contemplating new regulation of the terminating access services of non-dominant CLECs. These incongruous proposals fly in the face of the Commission's other deregulatory initiatives and ignore the effects of market conditions on access prices. GTE believes that the Commission should be devoting its time and resources to phasing out of existence its outdated price cap and Part 69 rules, not to adding an unnecessary fresh coat of regulatory paint.

It is important to continue to focus on the principal objective, which is to eliminate pricing inefficiencies from ILEC access rates. Only if ILECs are allowed flexibility to adjust prices will customers and competition benefit from accurate pricing signals. The CALLS approach reflects a balanced, compromise approach to this end, and GTE strongly encourages the Commission to adopt its recommendations in addressing the issues in this proceeding.[5]

Furthermore, GTE recommends that the Commission seize the opportunity presented by this proceeding to promote deaveraged common line and switching rates

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5 However, the CALLS approach does not address every issue in the *FNPRM*.

in order to better reflect geographic differences in cost and access prices. In particular, GTE urges the Commission to:

- immediately allow ILECs voluntarily to deaverage common line and switching rates to achieve more cost-based rates and promote competition;
- follow the framework created in the *Fifth Report and Order* as the basis for Phase II deregulation of common line and switching services;
- not mandate that ILECs convert to capacity-based switching charges;
- not adopt new artificial price cap factors;
- refrain from tinkering with the increasingly archaic price cap system, but instead focus on streamlining, and eventually eliminating, it.

By transforming implicit support into explicit universal service fund contributions, and by allowing ILECs to deaverage rates, the FCC will significantly improve access pricing.

II. THE FCC SHOULD IMMEDIATELY PERMIT ILECs TO IMPLEMENT VOLUNTARY DEAVERAGING OF COMMON LINE AND SWITCHING PRICES IN ORDER TO ACHIEVE MORE COST-BASED RATES AND PROMOTE COMPETITION.

A. ILECs Should Be Permitted, But Not Required, To Deaverage Common Line Rates, At Least After Unbundled Network Element Loops Are Deaveraged.

The Commission has sought comment on whether to amend its Part 69 rules to allow geographically deaveraged common line rates.[6] Specifically, the *FNPRM* asks whether the FCC should "permit Incumbent LECs to deaverage common line access

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[6] *FNPRM*, at ¶ 190.

elements without a competitive showing, [or condition deaveraging based] on certain regulatory developments, such as deaveraging of unbundled network elements."[7]

GTE submits that ILECs should be allowed to deaverage common line access elements as a baseline change for the benefit of consumers, not predicated on regulatory developments. In any event, deaveraging must, as a matter of competitive equity, occur no later than the implementation of deaveraged UNEs.[8]

1. Cost causation principles demand that loops be priced on a deaveraged basis.

It is indisputable that price deaveraging is in the public interest. Indeed, the Commission already has ordered loop deaveraging in the UNE environment.[9]

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[7] *Id.* at ¶ 190-92.

[8] The CALLS proposal contains a limited common line deaveraging proposal that is not implemented until after UNEs are deaveraged. The CALLS proposal does not completely resolve all issues with respect to geographic deaveraging. *See* CALLS Proposal, Attachment A, at 9.

[9] *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* ("*Interconnection Order*"), 11 FCC Rcd 15499 (1996); *Iowa Utils. Bd. v. FCC*, 96 F.3d 1116 (8th Cir. 1996) (per curium) (temporarily staying the Local Competition Order until the filing of the court's order resolving the petitioners' motion for stay); see also *Iowa Utils. Bd. v. FCC*, 109 F.3d 418 (8th Cir. 1996) (dissolving temporary stay and granting petitioners' motion for stay, pending a final decision on the merits of the appeal); *Iowa Utils. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd in part and aff'd in part*, *AT&T v. Iowa Utils. Bd.*, 119 S.Ct. 721 (1999), on remand, *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 8300 (1999) (issuing a stay of the Commission's rules requiring states to establish at least three geographic rate zones for unbundled network elements). *See also FCC Reforms High-Cost Support to Ensure the Preservation and Advancement of Universal Service*, FCC Press Release, CC Docket No. 96-45, Oct. 21, 1999 (lifting the stay of the Commission's rule "requiring each state commission to establish different rates for interconnection and unbundled

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Deaveraged prices more closely approach cost-based rates than the current averaged rates, and it should be unquestionable that the more accurate price signals generated by deaveraging are in the public interest.

Fundamental to a discussion of loop price deaveraging is an understanding that loop costs vary based on the characteristics of the geographic area, including customer density, difficulty of terrain, and customer location. The economies of loop provisioning vary based directly on these external factors. Because customer density is higher in certain areas, particularly urban areas, overall loop costs are less in those areas. However, the current system for setting common line rates fails to consider these fundamental cost differences. In particular, current study areas are too large to account for these cost differences. To the extent that costs are averaged across local markets, study-area wide prices will be too low in some areas, and too high in others. Because these are not cost-based prices, inefficiencies result.

Geographic loop deaveraging addresses these concerns. GTE believes that geographic deaveraging is indispensable to creating cost-based common line loop prices:[10] To ensure that prices are more aligned with costs, carriers must be allowed to

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network elements in at least three defined geographic areas within the state to reflect geographic cost differences").

[10] "There is widespread consensus among economists that when costs are fixed, as loop costs are, markets tend to push prices toward flat-rated, rather than usage-based, price structures. [However,] the current rate structure does not do that. By inflating usage and business charges above market-based levels, it instead promotes competition for high-volume, typically high-revenue, low-cost business users." CALLS

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eliminate "geographic rate averaging ... and other cross-subsidies in the rate structure."[11] LECs should be allowed to deaverage loop prices to reflect geographic differences in costs.

These inefficiencies have broader implications for investment in facilities. The Commission itself has already recognized the distorted price signals created by geographic averaging:

> [D]iscrepancies between price and cost distort competition by creating incentives for entry in low-cost areas by carriers whose cost of providing service is actually higher than the incumbent LEC's cost of serving that area. Similarly, geographic averaging across large geographic areas distorts the operation of markets in high-cost areas when we require incumbent LECs to continue offering services in those areas at prices substantially lower than their costs of providing those services. Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC.[12]

The public interest in rates more closely aligned with costs justifies allowing access price deaveraging immediately rather than delaying it indefinitely until other

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Proposal at 12-13, citing Alfred E. Kahn and William B. Shew, *Current Issues in Telecommunications Regulation: Pricing*, 4 Yale J. on Reg. 191, 203-04 (1987); David L. Kasserman and John W. Mayo, *Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing*, 11 Yale J. on Reg. 119, 125(1994); Steve G. Parsons, *The Economic Necessity of an Increased Subscriber Line Charge (SLC) in Telecommunications*, 48 Admin. L. Rev. 227, 235-36 (1996).

11 Affidavit of J. Gregory Sidak and Daniel F. Spulber, USTA Initial Comments, Access Charge Reform, CC Docket 96-262, at 11 (Jan. 29, 1997).

12 *Access Charge Reform*, Notice of Proposed Rulemaking, 11 FCC Rcd 21354, at ¶ 183 (1996).

regulatory developments occur. Deaveraging would bring immediate benefits through the promotion of rates more aligned with costs, and more efficient pricing regardless of the state of competition. Further delay would merely further harm the public interest.

2. Deaveraged pricing promotes competition and benefits consumers in both urban and rural areas.

A second shortcoming of the averaged rates produced under the current system are the implicit cross-subsidies between high cost and low cost areas. These implicit subsidies from urban to rural areas violate the explicit subsidy requirements of the Act and stall competition – all to the detriment of the consumer.[13] Implementing geographic deaveraging will promote competition in, accelerate investment into, and eliminate historical implicit subsidies between, urban and rural areas and improve consumer welfare.[14]

The historical subsidy from urban to rural areas embedded in averaged access charges is well documented: "In 1997, the Commission [recognized] geographic rate averaging between higher cost and low cost areas [as a form of] implicit support for universal service."[15] The Commission concluded that "[e]fficient competition in local markets is most likely to occur when rates for services, after factoring in explicit

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13 47 U.S.C. § 254(e).

14 A complete solution to these issues requires deaveraging at both the federal and state levels. *See* Section II.A.3.d. *infra*.

15 *See* CALLS Proposal, at 4.

universal service contributions or support, reflect the underlying cost of providing service."[16] Even AT&T and MCI have argued that "averaged rates represent precisely the type of urban-to-rural implicit subsidy that the Act expressly prohibits."[17]

These current implicit supports can "delay or deny the benefits of competition to residential and high-cost consumers if a competitor finds that it is unable to compete against an incumbent's artificially low rates."[18] In rural areas where subsidized rates provide no incentive for competitors to enter the rural market, geographic deaveraging will encourage efficient facilities investment. It will allow ILEC access prices to more closely resemble costs, and erase uneconomic incentives to enter the market in search of artificially created higher profits. For this reason, common line deaveraging is necessary as a matter of competitive equity. As the Commission itself has noted:

> [W]here unbundled network elements are deaveraged, continuing to require incumbents to charge access rates that are averaged across the study area may foreclose the incumbent LEC from meeting competition from unbundled network elements in low-cost areas.[19]

The inequity is reversed in favor of the ILEC in high cost areas.

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16 *Id.* at 7.

17 Reply Brief filed by MCI WorldCom Inc. and AT&T Corp., *MCI WorldCom Inc. v. FCC*, Nos. 99-1182, *et al.*, 4 n.3 (D.C. Cir., filed July 12, 1999).

18 *Seventh Report and Order and Thirteenth Order on Reconsideration*, 14 FCC Rcd 8078, at ¶ 7 (1999).

19 *FNPRM*, at ¶ 192.

A decision to allow deaveraged pricing is also supported by the Commission's recent authorization of zone density pricing for switched and special transport. The Commission has liberalized the geographic deaveraging rules for switched transport and special access services by allowing LECs to define zones, as long as (1) each zone except the highest cost zone comprises at least 15 percent of revenues and (2) price increases in each zone are limited to 15 percent a year, relative to the PCI.[20]

There is no reason to refrain from geographic deaveraging due to alarmist concerns over the effects on high cost customers. The appropriate mechanism for addressing this is set forth in Section 254 of the Act, the universal service mechanism. This fund was developed to address the need for high cost support. This type of explicit subsidy for a high-cost area is exactly what was contemplated by both Congress and the Commission. If it is necessary to limit increases in SLCs in high cost areas to promote affordability, then increases will be capped by explicit universal service funding, not by averaging with lower cost areas.

The CALLS plan is a necessary supplement to geographic deaveraging of common line rates. "The CALLS plan . . . substantially reduces the implicit support of rural rates by urban ratepayers . . . . By integrating SLC deaveraging with explicit universal service support and deaveraging UNE loop rates, the plan strengthens both

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[20] *Fifth Report and Order*, at ¶¶ 59 & 63.

rural and urban competition and ensures affordable rural rates."[21] Accordingly, "residential and rural line charges will be structured to face competitive pressure."[22]

Loop price deaveraging will produce more accurate pricing signals to both consumers and competitors. The new USF fund proposed by CALLS provides a simpler, more direct, and explicit means of providing appropriate subsidies than averaged prices. GTE urges the Commission to adopt full geographic deaveraging, as well as the more limited, but important, deaveraging contained in the CALLS proposal.

3. ILECs should be given the discretion to establish zones.

a) ILECs should have the ability to establish zones that more accurately reflect cost and market differences.

There may be different cost and market characteristics that could justify different zones for loop and transport pricing. For instance, loop costs are primarily affected by length and location. Trunk costs, on the other hand, are influenced not only by length, but also by traffic density, trunk capacity, and other factors. Accordingly, carriers should be allowed to establish their own zones based on the distinct cost characteristics of loops and trunks, and not forced to consolidate trunk and loop costs together.

Allowing ILECs to establish loop zones different from trunk zones will benefit consumers. Market forces will direct ILECs to align prices with costs, to the greatest

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21 CALLS Proposal, at 18-19.

22 *Id.* at 14.

extent possible, to allow them to compete in an environment of deaveraged UNEs. Thus, ILECs will be driven by marketplace forces to price in a way that enhances competition, increases consumer choice, and prevents the uneconomic arbitrage opportunities discussed below. However, ILECs should not be forced to establish new zones. ILECs should have the ability to choose whether or not to establish new zones based on an analysis of the costs to be incurred versus the benefits to be achieved if new zones are established. Therefore, carriers should be allowed to choose whether to use the same or different zones.

b) The FCC should allow ILECs to establish loop zones that are consistent with UNE and USF zones in order to prevent arbitrage.

The FCC seeks comment on whether geographic pricing zones for common line charges should be based on UNE loops or universal service zones or, perhaps, trunking basket service zones and "whether the use of different zones for unbundled network elements, universal service, and access charges would create inefficiencies and arbitrage opportunities."[23] GTE believes that the use of different zones for USF, UNE loops and SLCs could lead to a competitive imbalance and uneconomic arbitrage, and therefore should be avoided. Instead, carriers should have the flexibility to use the same zones.

If ILECs are required to set access prices based on one set of zones while UNE loop rates are set based on another, it is certain that uneconomic arbitrage will occur.

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[23] *FNPRM*, at ¶ 198.

For example, if UNE loops are set at a lower rate than common line charges because the UNE loop rate is based on a different zone, the

> divergence between element prices and regulated access charges [would] create[] an artificial incentive to substitute unbundled network elements for access. Such artificial incentives mean that carriers would potentially choose the less efficient alternative or an alternative with high transaction costs to bypass access charges (or to take advantage of regulated unbundled network elements set at artificially low prices).[24]

As competitors take advantage of these arbitrage situations, inefficient market distortions will occur. In order to address these potential inequities in the system, GTE believes that carriers should have the flexibility to use the same zones for UNE loops and common line rates.

A second opportunity for economic inefficiencies will develop if different zones are chosen for the USF. If different zones are set for the USF and common line rates, universal service funding may not align with costs. Common line costs in a non-high-cost zone may overlap a USF high-cost zone, resulting in USF funding for a region not in need of support. This mistargeting of funds would again result in an implicit subsidy in violation of section 254(e) of the Act. The solution is to allow carriers to use the same zones for UNE loop, USF, and common line access price deaveraging.[25]

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24 Affidavit of J. Gregory Sidak and Daniel F. Spulber, Attachment 3, Comments of the United States Telephone Association, CC Docket No. 96-262, at 9 (filed Jan. 29, 1997).

25 The CALLS proposal uses the same zones for USF, UNEs, and SLCs. Under the CALLS proposal, "ILECs may only geographically deaverage their SLCs on the

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c) **If UNE loop zones are used, it would be unnecessary to obtain FCC approval for establishing the zones that states have already approved pursuant to FCC criteria.**

In its *Interconnection Order*,[26] the Commission concluded that "three zones are presumptively sufficient to reflect geographic cost differences in setting rates for interconnection and unbundled elements, and that states may, but need not, use these existing density-related rate zones."[27] If zones were not in existence at the time of the *Order*, the Commission concluded that states "shall create a minimum of three cost-related rate zones to implement deaveraged rates for interconnection and unbundled elements."[28] States have the option of establishing more than three zones.[29]

If the Commission allows ILECs to use these established UNE zones when deaveraging common line rates, a carrier should not be required to secure Commission approval for the zone before filing a tariff if the state has adopted the zone in accordance with Commission rules. For the FCC to reconfirm a state decision would be

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same geographic basis as state-approved UNE loop zones." CALLS Proposal, Appendix A, at 2.

26 *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* ("*Interconnection Order*"), 11 FCC Rcd 15499 (1999).

27 *Interconnection Order*, 11 FCC Rcd, at ¶ 765.

28 *Id.*

29 *Id.*

a waste of resources. Further, the FCC's actions would unnecessarily call into question the decision of the state PUC that established the zone pursuant to FCC criteria.

d) At the same time, states must address the retail loop pricing problems within their own jurisdiction.

Even if the deaveraged zone recommendations discussed above are followed, an implicit subsidy that undermines competition remains. In some areas, intrastate retail prices generally are averaged between urban and rural areas. In other cases, historical prices are lower in rural than in urban areas. In either case, intrastate retail prices are not aligned with the geographic differences in costs. Therefore, they will not be aligned with USF, UNE or access prices. These current implicit subsidies in local service rates – urban to rural, business to home – must be addressed. While GTE recognizes that the FCC has no control over these prices, all regulators must acknowledge that eliminating implicit subsidies and promoting local competition depends on the willingness of states to allow carriers to correct intrastate retail pricing over time.

4. Current SLC caps should be modified in line with the CALLS proposal.

Finally, along with allowing ILECs to deaverage common line rates and establish zones separate from trunking zones, the Commission should adjust the current caps on SLCs. The benefits of deaveraging will not be achieved if caps remain at their present levels, which simply do not provide enough room for SLC deaveraging. Only by moving the caps to a reasonable level will ILECs be able to effectively implement deaveraged, cost-based, rates.

Accordingly, the Commission also should adjust current price caps pursuant to the gradual modifications specified in the CALLS proposal. The benefit of the CALLS plan is that it provides a comprehensive, albeit interim, means to realign access pricing to better accommodate competition and proper cost recovery combined with a modest explicit universal services support mechanism as contemplated by Section 254.[30]

The CALLS plan "would immediately eliminate all residential and single-line business PICCs, and reduce the multiline business PICC to no more than $4.00 per month."[31] Under the CALLS plan, "[r]esidential SLCs for price cap carriers are capped at $5.50 initially, with caps gradually increasing to $7.00 by July 2003. Deaveraged, multiline business SLCs are capped at $9.20 per month."[32] Explicit universal service funding totaling $650 million will support these caps.[33] This plan will establish a fair and stable basis upon which reasonable deaveraging can take place. Only with these changes can the benefits to consumers and competition be achieved.

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30 CALLS Proposal, at 12.

31 *Id.* at 11.

32 *Id.* at 9. The CALLS "plan increases the primary residential and single-line business SLC cap to $7.00 in three phases. The primary residential and single-line business SLC cap rises to $6.25 on January 1, 2001, to $6.75 on July 1, 2002, and to $7.00 on July 1, 2003." *Id.* at 16.

33 *Id.* at 9.

B. Carriers Should Be Allowed, But Not Required, To Deaverage The Switching Rate Structure.

Geographic cost differences also may exist in traffic sensitive elements such as switching, although these cost differences are smaller than local loop geographic cost differences. For example, rural areas tend to be served by smaller switches than urban areas, which may result in a higher cost per minute.

The Commission already has recognized that switching costs differ among carriers, concluding that "smaller telephone companies have higher switching costs because they cannot take advantage of certain economies of scale."[34] This conclusion applies equally to all carriers. Switching costs differ based on the location of the switch and the amount of traffic that flows through it. If carriers are allowed to geographically deaverage switching prices, the prices will more closely reflect costs. For this reason, ILECs should be allowed to zone price the traffic sensitive rates to account for these cost variations. As with other elements, ILECs could then balance costs of establishing separate rate zones with the benefits to be gained in more efficient pricing.

Permitting ILECs to deaverage switching rates geographically will better align prices with cost. This should result in better price signals to encourage economic investment in local switching facilities. As arbitrage opportunities disappear, competitors will abandon uneconomic decisions based on inaccurate market information. Facilities-based entry to the market will become a more attractive

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[34] *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint* Board, 10 FCC Rcd 12309, at ¶ 9 (1995).

economic decision. This will advance the Commission's goal of establishing facilities-based competition in the market for local telephone service.

III. THE FRAMEWORK FOR PRICING FLEXIBILITY ESTABLISHED IN THE *FIFTH REPORT AND ORDER* IS A REASONABLE BASIS FOR PROCEEDING TO PHASE II DEREGULATION OF COMMON LINE AND SWITCHING SERVICES.

A. Phase II Relief For Common Line And Switching Should Be The Same As For Phase II Relief For Special Access Services: Freedom From Price Caps And Streamlined Tariffing.

The Commission has sought comment on the nature of the relief that should be granted to price cap LECs who have satisfied the Phase II triggers for the provision of common line and traffic sensitive services, and the traffic-sensitive components of tandem-switched transport services.[35] Specifically, the *FNPRM* asks whether the Phase II relief should be similar to that granted to ILECs' dedicated transport and access services – that is, ILECs would no longer be required to comply with Part 69 rate structure rules with respect to common line and traffic sensitive services, may remove them from price caps, and may file tariffs for these services on one day's notice (so long as such tariffs are made generally available).[36] Further, this relief would be provided on an MSA/RSA geographic basis.

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[35] *FNPRM*, at ¶ 204. For purposes of this discussion, we will refer to these services as common line and traffic sensitive services in these comments.

[36] *Id.*